Personal Planning Strategies

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$5 Million Gift Tax Exemption Still Alive and Kicking

Before the Joint Select Committee on Deficit Reduction, otherwise known as the Super-committee, failed to come to any bipartisan agreement to cut the deficit earlier this week, rumor had it that the committee would propose legislation to reduce the gift tax exemption from $5 million to $1 million. The unsubstantiated rumor claimed that the lower exemption would go into effect on November 23, 2011. That day has come and gone, and the gift tax exemption amount remains at $5 million.

While rumors come and go, we continue to recommend that our clients use the $5 million exemption in 2011 or 2012, since the favorable exemption amount will remain in effect only through December 31, 2012, when the current law allowing the large exemption is scheduled to sunset. Unless Congress acts before that date, the law will revert to the less favorable $1 million gift, estate, and generation-skipping transfer (“GST”) exemption amount. In addition, the top marginal gift, estate, and GST tax rates will rise from the current 35% to 55%. That means that an individual who has not used his exemption and makes a gift of $5 million before January 1, 2013 will pay no tax, but if he waits until 2013 to make the same gift, it will be subject to a gift tax to the extent his cumulative taxable gifts exceed $1 million.

The $5 million exemption per person ($10 million for married couples) allows individuals to reduce their estate by simply making direct gifts to their descendants or anyone else they wish to benefit (or to trusts for their descendants). In addition, even if the entire exemption amount was used in previous years, an individual may still take advantage of the additional $4 million increase allowed in 2011 and 2012. By making a gift now, all appreciation and income on the gifted asset will be removed from the estate tax-free. And, if the gift is made to a grantor trust so that the grantor pays the income taxes on the trust’s income, the income tax paid also is removed from the grantor’s estate tax-free!

With the 55% rate on the horizon, we recommend that our clients make taxable gifts to take advantage of these favorable laws before they expire at the end of 2012. In addition to paying tax at a lower rate, the gift tax paid is removed from the estate (assuming one lives for three years or more from the date the gift is made), and all the appreciation and income (and income taxes if the gift is made to a grantor trust) on the gifted assets is removed from the estate.

For example, a gift of $5 million made in 2012 by an unmarried individual who had used his $5 million gift tax exemption in 2011 would result in a gift tax payable of $1,750,000. In 2013, the same $5 million-dollar gift would result in a gift tax payable of $2,750,000. Moreover, assume that the individual dies in 2020 and that there is 5% growth, the gift tax of $1,750,000 and the appreciation of $2,387,277 (compounded annually over eight years) would be removed from his estate tax-free.

There are many ways to maximize the use of the $5 million exemption and 35% rate. Please contact us to discuss a structure that works best for you and your family. This could be the best gift you can make during the holiday season!

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